# ANALYSIS OF ORIGINAL BILL

**Franchise Tax Board**

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| Author: | Poochigian | Analyst: | Kimberly Pantoja | Bill Number: | SB 877 |
| Related Bills: | See Legislative History | Telephone: | 845-4786 | Introduced Date: | 02/23/01 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Dairy Farm Property Taxes Credit/Fixtures and Improvements for Fuel or Energy Resources

## SUMMARY

This bill would create a tax credit for the property taxes paid and attributable to certain fixtures and improvements used for the cogeneration or transformation of dairy industry by-products into fuel or energy resources used to operate a dairy farm.

This analysis will not address the bill's sales and use tax exemption provision as it does not impact the department's programs and operations or state income tax revenue.

## PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to encourage innovative, self-sustaining methods to convert agricultural waste into energy.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective upon enactment. The credit would be operative for taxable years beginning on or after January 1, 2001, and does not have a sunset date.

## POSITION

Pending.

### Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the concerns discussed below.

## ANALYSIS

FEDERAL/STATE LAW

Both state and federal laws allow a deduction for all ordinary and necessary expenses of a trade or business, including expenses relating to energy conservation measures. If the expense is for a repair to existing equipment that does not extend the useful life of such equipment, it is deductible in the year paid or incurred.

| Board Position: | | | Department Director | Date |
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If the expense is for a replacement, and the useful life of the equipment replaced is more than one year or the repair extends the useful life of the equipment, the cost is recovered by depreciation deductions over the useful life of the equipment.

Both state and federal laws allow individuals a deduction for personal property taxes imposed by a state or local government. The tax must be imposed annually on the personal property based on the value of the personal property. Real property taxes are also deductible unless the taxes are for local benefits that increase the value of the property.

Both state and federal laws provide various tax credits designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Neither state nor federal laws have a credit comparable to the credit proposed by this bill.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to the portion of California property taxes paid that are attributable to fixtures and improvements of a dairy farm. The fixtures and improvements must be utilized in the cogeneration or transformation of dairy industry by-products into fuel or energy resources used for the operation of the dairy farm.

This bill defines "dairy farm" as any place where milk is produced for sale or other distribution and where more than two cows or six goats are in lactation.

Any excess credit may be carried over until exhausted.

IMPLEMENTATION CONSIDERATIONS

The bill uses the terms "cogeneration" and "by-products." However, these terms are not defined in the bill. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

It is also unclear how taxpayers or the department would determine the amount of property tax that is attributable to the fixtures and improvements if this amount of tax is not separately stated or otherwise identifiable.

## LEGISLATIVE HISTORY

SB 16X (Soto, 2001/2002) would create a refundable tax credit for the purchase and installation of generators used to produce electricity at dairy farms located in California. The bill is currently in the Senate Revenue and Taxation Committee.

## OTHER STATES' INFORMATION

The laws of the following states were reviewed because of similarities to California's income tax laws. Only one state has a credit related to farmland.

*Michigan* allows individual taxpayers an income tax credit for property taxes paid on farmland. The credit allowed is for the amount by which the property taxes on land and structures used in the farming operation and restricted by a development agreement exceed 7% of household income, excluding any depletion deduction.

The following is a brief list of incentives provided for energy conservation by the comparison states.

*Massachusetts* has an extensive program of tax exemptions and credits designed to encourage the consumption and production of energy efficient systems and alternative energy systems. These tax benefits include the following: individuals are allowed a credit for the purchase and installation of solar or wind energy systems for their residence; and businesses are allowed a deduction for the purchase and installation of solar and wind energy systems for heating, air conditioning, or water heating purposes.

*Michigan* does not generally provide energy conservation incentives through the tax system but uses an extensive system of grant and loan incentives to encourage investment in alternative energy and energy conservation.

*New York* has programs designed to affect both the consumption and the production of energy conservation systems and alternative energy equipment. Individuals are allowed a credit equal to 25% of certain solar electric generating expenditures.

Florida, Illinois, and Texas do not provide a tax credit comparable to the credit proposed in this bill.

**FISCAL IMPACT**

This bill is not expected to impact the department’s costs significantly.

**ECONOMIC IMPACT**

The revenue loss of this measure under the income tax laws would be minor, less than $500,000 annually.

Contacts with industry experts indicated that the incentive effect of this measure could be marginal. Staff assumed that 5% of California dairy farms, about 2,200 in number, would take advantage of this proposal. Cost data were obtained from industry experts. The negative tax revenue impact of the measure was offset somewhat by a reduction in deductions due to the sales tax exemption provision of the proposal.

**ARGUMENTS/POLICY CONCERNS**

Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense or is depreciable. Providing a taxpayer both a credit and a deduction for the full amount of an expense would have the effect of providing a double benefit for that expense item. On the other hand, making an adjustment to reduce basis or to deny a deduction in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general conformity policy. In the case of a one-time business expense deduction, the reduction of that expense by the amount of the credit would not create an ongoing difference.

This bill does not restrict the credit to farms located in California. However, if the author restricts the credit to farms located in California, the result may be an unconstitutional government subsidy for the local dairy industry. The author may want to consider offering taxpayers a property tax credit or exemption.

The credit does not specify a repeal date or any limitation on the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

**LEGISLATIVE STAFF CONTACT**

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